

VDH/OFFICE OF DRINKING WATER
FINANCIAL AND CONSTRUCTION ASSISTANCE PROGRAMS (FCAP)

Building Financial Sustainability/Financial Health Indicators

Having adequate financial capacity and an acceptable credit review is a Program requirement for revolving fund loan projects. Listed below are some financial indicators that may be evaluated during a review by VDH or by the Virginia Resources Authority (VRA). Reviews are not limited to the factors listed below and may include other factors.

Revenue Pledge Factors: *(User fees pledged for loan repayment)*

1. **Debt Service Coverage Ratio:** Net Revenue (revenue – O&M) available for debt service divided by applicable debt service. Evaluated using the first two fiscal years after project completion.
 - Poor Less than 1.15x
 - Adequate From 1.15x to 1.5x
 - Strong Greater than 1.5x
2. **Days Cash on Hand:** Amount of total available unrestricted liquid reserves divided by daily operating expenditure requirements.
 - Poor Less than 60 days
 - Adequate From 60 to 120 days
 - Strong Greater than 120 days
3. **Operating Ratio:** Total operating income plus operating reserves divided by total operating costs (not including debt)
 - Poor Less than 1.1
 - Adequate From 1.1 to 3.0, Small systems (1.25 to 3.0), Medium and large (1.1 to 2.0)
 - Strong Greater than 3.0 Small systems (3.0), Medium and large (2.0)

General Obligation Factors:¹ *(Locality pledges its full faith and credit, backed by taxing power)*

4. **State Aid (if applicable):** Available state aid divided by applicable debt service.
 - Poor Less than 1.0x
 - Adequate From 1.0x to 1.5x
 - Strong Greater than 1.5x
5. **Debt Service vs. Expenditures:** Debt service compared to the total operating budget.
 - Poor Greater than 15%
 - Adequate From 10% to 15%
 - Strong Less than 10%
6. **Unassigned Fund Balance:** Unassigned fund balance vs. total revenue.
 - Poor Less than 5%
 - Adequate From 5% to 10%
 - Strong Greater than 10%

¹ Evaluate the debt, revenues, and expenses of the entire entity and not just the waterworks enterprise fund

7. **Debt Payout Ratio:** Measurement of how much debt is paid off in ten years.

- Poor Less than 50%
- Adequate From 50% to 60%
- Strong Greater than 60%

8. **Total Debt vs. Total Valuation:**

- Poor Greater than 6%
- Adequate From 2% to 6%
- Strong Less than 2%

Other Factors:

9. **Affordability Index Target:** Annual residential bill divided by Annual Median Household Income (MHI).

- 1% for average gallons per month*
- 2% for 5,000 gallons per month

* Use the rate structure (in-town, if applicable) for residential customers and apply it to the average monthly residential water usage to derive the average monthly user rate for evaluation under the DWSRF Program. The average monthly residential water usage is to be based on the aggregate residential water meter data. Waterworks are expected to meet or exceed the target rate criteria at the time of project completion.

Other Considerations:

Experience has shown that fairly structured utility rates that implement gradual rate increases annually have been the most acceptable to the ratepayers and most effective in keeping revenue at pace with costs. VDH recommends rate adjustments to ensure minimum compound revenue increases of 2%² each year.

VDH recommends waterworks implement a revenue growth model that factors in increases (e.g. operational costs, inflation, etc.), other costs (e.g. asset/equipment replacements, technology upgrades, capital improvements, etc.), and takes into account other potential revenue reductions (e.g. future regulations, reductions from water conservation, etc.).

VDH recommends waterworks establish and fund a protected capital reserve fund that adequately supports capital improvements and asset replacements.

Three key elements to an effective revenue protection plan:

1. Protect the fund from being used for other purposes.
2. Provide for the future needs for replacement and upgrades,
3. Maintain the fund value at the necessary levels to sustain operations in perpetuity

VDH reserves the right to require an implementation schedule acceptable to VDH for those waterworks that may need additional time for implementation of significant rate increases.

² Alternatively owners may use an inflationary linked index such as the Consumer Price Index (CPI) or the Personal Consumption Index (CPE).